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The Association between Abnormal Audit Fees and Audit Quality after IFRS Adoption in Korean Audit Service Market

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ABSTRACT

The Association between Abnormal Audit Fees and Audit Quality after IFRS Adoption in Korean Audit Service Market

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This study reexamines the relationship between abnormal audit fees and audit quality after International Financial Reporting Standards (IFRS) adoption. Using empirical data collected over the period from 2008 to 2013, this study finds that there exists no significant relationship between abnormal audit fees and audit quality measured by the magnitude of discretionary accruals in the pre-IFRS adoption period. However, the relationship between abnormal audit fees and the magnitude of discretionary accruals turns to be positive in the post-IFRS adoption period. These findings suggest the following two possible reasons. First, the IFRS enables some clients to engage more discretion in the choice of discretionary accruals and auditors charge higher fees in return for allowing the discretion for such clients. Second, auditors extend the scope of audit to mitigate the audit risk for clients who engage in extensive earnings management using discretionary accruals. As a result, audit fees increased for such clients.

Key words : IFRS; abnormal audit fees; audit quality; discretionary accruals; audit fees

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I. Introduction

The purpose of this study is to reexamine the association between abnormal audit fees and audit quality. Especially, this study examines whether the audit fees received above its normal level lead auditors to compromise or improve audit quality. And how the abnormal audit fee and audit quality relationship has been changed after adoption of International Financial Reporting Standards (hereafter "IFRS").

One basic idea that explains this relation is economic bonding between auditor and client based on the concerns of impairment of auditor independence which may lower audit quality. The economic bonding occurs when clients overpay auditors in return for allowing managerial discretion in financial reporting (Choi et al, 2010). The other explanation that received significant research attention is audit effort view that abnormal audit fee compensates for auditors' additional efforts that contribute to the increase of audit quality.

In Korea, there is fierce competition in audit service market, so client demand fee discount consistently. It drives prevalent fee discounting phenomenon in the first year of audit (Lee et al,2011) and also prevent appropriate fee increase from reflecting relevant risk assessed by auditors(Lee et al,2009). In addition, audit risk is relatively lower in Korea than that in other developed countries regarding litigation risk measured by Wingate litigation index (Wingate 1997; Choi et al 2008). As a result, auditors have less incentive to provide high quality audit service. In such a situation, if clients pay higher than normal level of fees in anticipation of auditor's approval for specific accounting treatments, auditor and client can economically bond together, resulting in impaired audit quality (Choi et al,2010).

However, concerning Korean local audit service market condition of which audit fee is generally discounted by overheating competition, abnormally high audit fee paid to auditors is likely to compensate auditors' effort that has not been adequately compensated before, which subsequently contributes to the increase of audit quality to some extent In this case, economic bonding theory may not be applicable in Korean audit service market.

IFRS is principle-based so accounting policies of how each principle should be implemented is not prescribed in details. This may inevitably trigger managerial discretion and subjectivity (Ahmed et al ,2012). Accordingly, it requires auditor's professional judgment about the firm's discretion in which extent for auditor to accept the proposed accounting treatment. Auditors have to allocate additional efforts on wider range of accounting choices and complexity. Therefore audit fees are increased in overall by reflecting additional audit efforts after adoption of IFRS. IFRS itself can be good chance for firms with intention of manipulating earnings to accomplish their financial targets in collusion with auditors.

Concerning the uniqueness of Korean audit service market, there expects to be interesting view point which is distinguishable from the international evidence that explains the audit fee and audit quality relation. And moreover, given the change of external accounting environment by adopting IFRS, I expect there may be some meaningful dynamics which change the audit fee and audit quality relation compared to before IFRS period. But I cannot predict the direction of association between the two based on the conflicting arguments I discussed above.

A number of empirical studies examine whether the abnormal audit fee affects audit quality based on two theoretical evidence, economic bonding and audit effort. My research also tested the abnormal audit fee-quality relation based on two different theories but I examined the relation in Korea's specific audit market

situation with intensifying competition and discounting audit fee. I expand the framework to consider IFRS effect, which increases the managerial discretion and overall audit fee, on abnormal audit fee and audit quality relation.

As in previous studies on the audit fee and audit quality relationship, I use the absolute magnitude of the amount of discretionary accruals as proxy for audit quality (Reynolds and Francis 2001; Frankel et al 2002;Balsam et al 2003; Chung and Kallapur 2003; Francis and Yu 2009; Boone, Khurana, and Raman 2010; Choi et al. 2010; Reichelt and Wang 2010; Lopez and Peters 2012; Asthana and Boone 2012).

My empirical results can be summarized briefly as follows. Firstly, the abnormal audit fee is significantly and positively associated with the absolute magnitude of discretionary accrual for total sample firm-year. Secondly, after I include IFRS dummy variable in the main regression model in all sample firm-year, it shows more significant and positive association between abnormal audit fee and the unsigned magnitude of discretionary accrual. This is consistent with the findings of economic bonding in prior studies that use similar empirical settings (DeAngelo 1981a,1981b, Choi et al 2010). I partition the sample year from before IFRS and post IFRS to assess whether the sensitivity of audit quality to abnormal audit fees differs between the two periods. Interestingly, the result from each sample period is quite different from each other. Before IFRS, the test presents no association between abnormal audit fee and the absolute magnitude of discretionary accrual. But with respect to the effects of IFRS, result shows meaningful implication that the association turns to be significantly positive.

The evidence presented in the paper suggests two important findings.
First, the IFRS enables some firms to engage more managerial discretion through wider choices of discretionary accrual in collusion with auditors. Second, auditors exert more audit efforts to mitigate the audit risks for firms with high magnitude of

discretionary accrual. These two findings suggest audit fee increase for such firms.

The remainder of the paper is as follows. The second contained a prior literature review, the third section is the hypothesis development, the fourth section contains the sample selection criteria and descriptive statistics, and the fifth section contains the research design and the sixth section contains main empirical results. The seventh section contains further analyses, and the eighth section concludes this paper.

II. Literatures

2.1 Economic bonding VS. Audit efforts

Audit fee is divide into two parts, one is normal and the other is abnormal part of audit fee. Normal audit fees are the fees that are rationally expected given the client's size, risk, and complexity. Therefore the actual audit fee paid above the normal audit fee is assumed as abnormal audit fee (Eshleman et al 2014). Abnormal audit fee is unexpectedly high, thus it may better capture the profitability to auditors the services provided. Researchers are interested in abnormal audit fee and audit quality relation whether receiving abnormally high audit fee increases or decreases audit quality.

There are two different theories that explain this relation. The first theory is based on "economic bonding view" which regards abnormally high audit fee as bribes or economic rents being earned by the auditor (Kinney and Libby 2002). Thus abnormal portion of audit fees beyond the normal level of audit fees give

auditors incentives to loose independence. Several prior researches find the economic dependence of the audit firms on their clients. (DeAngleo 1981; Beck et al. 1988; Magee and Tseng 1990; Choi et al 2010). The other theory is based on "audit effort view". Higher audit fees are reflecting additional working hours and better audit qualities to maintain their reputation or to prevent auditors from increasing audit risk of earning management (Francis and Krishnan 1999). The finding of Blankley et al (2012) is also consistent with audit effort view in that clients paying abnormally high audit fees produce higher quality of accounting information with less restatement afterward. Higgs and Skantz 2006 also find positive and significant association between abnormal audit fees and audit quality. Prior literatures offer mixed results on the relations between audit qualities and abnormal audit fees.

2.2 Abnormal audit fees

In competitive audit service market, audit fee is determined by costs of audit efforts expended and audit risks assessed by auditors (Simunic 1980; Choi et al 2008; Asthana et al 2012). Empirical research models that estimate audit fee is specified as a function of auditor's cost in performing the audit, other relevant units expended, expected litigation risks, and normal profit. (Asthana et al 2012).

But actual audit fees are limited in capturing the additional meaningful implication beyond surface. Kinney and Libby (2002) argues that unexpected fees may better capture the profitability of services provided. It means unexpected abnormal audit fee additionally explains the dynamic relation between audit firm and client derived from their pursued interests.

There are growing numbers of evidences that focus on the association between abnormally low or high audit fees and audit qualities. One stream of literatures examine a linear association between abnormal audit fees and audit quality whether

the association is positive or negative (DeFond et al 2002; Krishnan et al 2005; Hoitash et al 2007). And others test for a asymmetric association between abnormal audit fees and audit qualities (Larcker and Richardson 2004;, Higgs and Skantz 2006; Hope et al. 2009; Mitra et al 2009; Choi et al 2010). In this study, the linear association between abnormal audit fee and quality is tested on main regression model, and asymmetric association is additionally tested in robustness check.

Given the assumption that the audit fee model is well developed, the abnormal audit fee is estimated from residual audit fee.

III. Hypotheses Development

Prior literatures offer conflicting evidences about abnormal audit fee-quality relation as discussed. This paper reexamines the issue on sample of Korean audit service market with discounted audit fee premium from fierce competition.

Na et al.(2013) reports that audit fees are considerably discounted in Korean audit service market concerning the audit efforts and assessed audit risk. In this situation, concerning the relatively low audit risk compared to that of developed countries regarding the Wingate's 1997 litigation index. The Wingate litigation index is derived from an assessment of litigiousness for doing business as an auditor in each country and was developed by an international insurance underwriter for one of the Big 4 audit firms (Wingate 1997; Choi et al 2008). The index is ranging from 1 to 15 with the Korea taking the relatively low value of 3.6. Several other auditing literatures have used this index to proxy for litigation risk for a country (Choi and Wong 2007; Chung et al 2004). Auditors have less incentives to provide high quality audit service, this may lead auditors less likely to

exert more audit effort in Korea with relatively low audit risk and auditors are more likely to compromise their integrity in exchange for excessive audit fee received, in this situation, auditor and client can economically bond together which results in impaired audit quality.

On the other hands, Concerning the Korean local audit service market with highly discounted by fierce competition, abnormally high audit fee paid to auditors may remunerate the additional audit efforts and increased audit risk that are not fully compensated before, which is followed by audit quality enhancement (Jung Ho Park,2012). In this situation, abnormally high audit fees paid to auditors are regarded as compensation for increased audit efforts.

Taken these conflicting arguments together, I cannot predict the sign of the association between abnormal audit fees and audit quality in total sample firm year. Therefore, I formulate the following non-directional hypothesis, stated in null form;

H1: Abnormal audit fees are not associated with the absolute magnitude of discretionary accruals in Korean audit service market.

After IFRS adoption, the audit firms are required to exert more audit efforts to conduct audit task with broader range of audit procedure and deal with increased audit risk, followed by overall audit fee increase. IFRS is principle-based, so managerial discretion is more prevalent without implementation guideline prescribed in details. This likely to lead some firms with bad intention to opportunistically manipulate earnings in collusion with audit firms that are paid excessively, which supports economic bonding story.

On other hands, prior literatures provide the evidence that IFRS adoption helps lower cost of equity capital (Daske et al. 2009: Li 2010), higher market liquidity (Leuz and Verrecchia 2010), accordingly more investment funds are attracted from

foreign mutual funds (Covrig et al. 2007). This substantially increased numbers of related parties make auditors exposed to the greater litigation risk in case stock market plunges. Thus auditors become more sensitive to audit quality after IFRS adoption, so auditors are more likely to extend the scope of audit to mitigate the audit risk, which results in the enhancement of audit quality. In this case, economic bonding theory may not be applicable in Korean audit service market.

Considering two opposite stories together, how IFRS adoption influences the audit fee-quality relation is empirical open question. Thus I also specify the following hypotheses in null form.

H2: The association between abnormal audit fee and the absolute magnitude of discretionary accruals is not affected by IFRS adoption in Korean audit service market.

IV. Sample Construction and Descriptive Statistics

4-1. Sample

I obtain financial and stock return data from KISVALUE and TS 2000 over 2006-2013 for Korean listed firm in KOSPI and KOSDAQ. Audit fee and audit hours are from TS 2000 and some missing data or some data with discrepancy is hand-collected from the Data Analysis, Retrieval and Transfer System (DART). Some of the control variables are one or two-year lagged, therefore, data from 2006 is needed to calculate the control variables and I use data up to 2013, which is latest published data. Table 1, describes the sample selection procedures. My initial sample consists of 17,017 firm year observation. I delete 3,247 observations for which audit fee and audit hour are invalid. I also drop 720 observations for which

control variables cannot be calculated. I finally drop the data beyond my sample period, the final sample consists of 10,856 observations.

[Insert Table 1]

4-2. Descriptive Statistics

Table 2 presents the descriptive statistics. First, the mean value of the magnitude of absolute discretionary accruals for sample firms is 0.008. This mean value is significantly larger than the median values, 0.005, meaning lDAl distribution is skewed. CHGSALE, EMPLOY, EXPORT, FOR and BIG which are direct or indirect measures for firms' size are generally skewed compared to median value of each variable while LNTA variable is reasonably distributed. Second, BTM, LEV, LFEE, INVREC_LAG, GRW_LAG are reasonably distributed. Third, on average, over 32 percent of the sample firms were involved in internal and external capital raising activities, nearly 25 percent of the sample firms experienced the loss, and over 56 percent of the total sample is audited by Big 4 audit firms while over 17 percent of total sample involve in first audit engagement. Fourth, about 1 percent of total sample does not receive clean opinion, and more than 40 percent of total firm-year is owned by largest and related parties. The overall properties of data distribution are relatively comparable to those of related studies conducted in Korea (Jung et al 2014).

[Insert Table 2]

4-3. Correlation Matrix

Table2 presents the Pearson correlation matrix for the variables used in Equation (3). The measure of absolute discretionary accruals, lDAl, is not significantly

correlated with ABAFEE, but most of other control variables in Equation (3) are significantly related to lDAl. It means that smaller firms, non-Big 4 audit firms, firms with high fluctuation of sales volume, loss firms, high leveraged firms, firms with initial audit engagement, and firms with lower level of operating cash flow, and firms that involve in capital raising activities are more likely to be associated with a high level of absolute discretionary accruals. This suggests the need for controlling the effects in the multivariate analyses. With respect to the extent of correlations among the explanatory variables, the firm size (LNTA) is significantly correlated with BIG, meaning large firms are more likely to hire BIG 4 audit firms. Except for the correlation between LNTA and BIG 4, the results of the multivariate regressions are unlikely to suffer from multicollinearity problem.

[Insert Table 3]

IV. Research Design

5-1. Measurement of Abnormal audit fee

To estimate the abnormal audit fee, I need to specify audit fee expectation model. And actual audit fee is dissected by two components, one is normal audit fee, which is expected audit fee, and the other is unexpected component audit fee, which is abnormal audit fee. Based on the prior literatures that examine the audit fee determinants (DeFond et al. 2002, Choi et al 2010, Jung et al 2014), I estimate the following regression model.

$$LFEE = LNTA\_LAG + EMPLOY + INVREC\_LAG + EXPORT\_LAG + ISSUE\_LAG + LIQ\_LAG + LEV\_LAG + ROA\_LAG + LOSS\_LAG + GRW\_LAG + BIG4 + OPIN\_LAG + FIRST + ONER + FOR + \sum IND + \sum YD + \varepsilon t \quad (1)$$

The control variables are included in the regression model to control the effects that influence the audit service fees. Audit service fees are likely to be increased by clients' sizable operations according to prior literatures (Simunic 1980; Choi et al 2008). I include LNTA_LAG, LEV_LAG, EMPLOY_LAG to control for client size. Audit service fees are also known to be positively associated with complexity of clients' operation (Simunic 1980; Choi et al 2008). So I include INVERC_LAG, EXPORT_LAG, FOR. I include LOSS_LAG, LIQ_LAG and ROA_LAG to control the clients' risk characteristics. Firms with low profitability or loss tend to have more potential risk that drives increase of audit service fee (Simunic and Stein 1996). LIQ_LAG captures both audit risk and liquidity risk of a firm. I include the Big 4 indicator variable to capture a Big 4 fee premium (DeFond et al 2000; Choi et al 2008). Prior studies consistently suggest that firms that hire Big 4 auditors pay higher audit fees than those that hire non Big 4 (Choi et al 2010). In addition, firms that need fund raising from outside debtors or inside equity shareholders need greater sources of audit service (Reynold et al. 2004,Choi et al 2010). The firms with high growth rate are also in need of more intense audit efforts to deal with relative issues arising from operations than firms with low growth rate, which leads subsequent audit fee increase (Choi and Wong 2007). To control these effect, I include ISSUE_LAG and GRW_LAG. I also include the OPIN_LAG to ensure that going concern opinion is issued before audit engagement. Prior literatures provided a positive association between corporate governance and audit fees (Carcello et al. 2002: Hay et al 2008). So I include ONER ,ownership of largest shareholder and

related parties. Following Lee et al, 2011, audit fee discount in the first year of the audit engagement is documented, so I include FIRST indicator variable to reflect discount phenomenon in initial audit period. Audit fee is generally determined the one year before the engagement year, thus I used lagged variable to estimate audit fee(Jung et al,2014). Finally I include indicator variables of year fixed effects and industry fixed effects to control for industry and yearly differences. Using the audit fee estimation model, I measure the abnormal audit fees by calculating differences between actual audit fees and estimated normal audit fees. In the main regression model, sample of 10,856 firm-years are used over six year period from 2008-2013.

5-2. Measure of discretionary accruals

Discretionary accruals is used as proxy for audit quality. Myers et al (2003) documents that In general, discretionary accruals capture the quality of accounting information, whereas other proxies for audit quality such as audit opinion and accounting fraud are mainly related to a limited situations. According to Park et al (2007) management prefers discretionary accruals to change of accounting treatment because of its characteristics of non-recognizable or distinguishable easily. In general, the higher discretionary accruals recorded are regarded as higher opportunistic behaviors (Dechow et al. 1995: Kothari et al. 2005). This analysis, the discretionary accrual, proxy for audit quality, is following the performance adjusted modified Jones model (Kothari et al 2005. Residuals from Equation (2) are the measure of discretionary accruals.

$$TA_t/A_{t-1} = \beta_0 + \beta_1(1/A_{t-1}) + \beta_2((\Delta REV_t - \Delta REC_t)/At\text{-}1) + \beta_3(PPE_t/A_{t-1}) + \beta_4 ROA_t + \varepsilon_t \quad (2)$$

Where,

TA_t	=	*Total accruals , Net income - cash flow from operations*
A_{t-1}	=	*Beginning balance of total assets*
ΔREV_t	=	*changes in sales*
ΔREC_t	=	*changes in receivables*
PPE_t	=	*Gross property, plant, and equipment minus land and asset under construction*
ROA_t	=	*Returns on assets*
ε_t	=	*error term*

5-3. Model for the Association between Abnormal Audit Fees and Audit Quality in Korean audit service market.

To examine the association between abnormal audit fees and audit quality in Korean audit service market, I regress DA variables, the unsigned magnitude of discretionary accruals following the performance adjusted modified Jones model (Kothari et al 2005), as the dependent variable, on ABAFEE, abnormal audit fee. And other control variables:

$$lDAl = \beta_0 + \beta_1 ABAFEE + \beta_2 LNTA + \beta_3 BIG + \beta_4 BTM + \beta_5 CHSALE + \beta_6 LOSS + \beta_7 LEV + \beta_8 ISSUE\_LAG + \beta_9 FIRST + \beta_{10} CFO + \beta_{11} ADJ\_TACC\_LAG + industry\ and\ year\ dummies + error\ term \quad (3)$$

DA denotes the magnitude of absolute value of discretionary accruals. I include LNTA to control for size effect because Dechow and Dichev says that large firms exhibit relatively lower level of discretionary accruals than smaller firms because of its stability and accuracy of predictability. I also include BIG to control for BIG

4 effect. Many auditing literatures generally report superior audit performance of Big 4 which restrict the high level of earning management (Becker et al. 1998; Francis et al 1999). And high growth firms are more likely to have potentials to manage earnings. So I include BTM and CHSALE. And I also include LOSS indicator variable to control the potential effect of risk of inflating or deflating earnings for firms experiencing loss or profit. Becket also argues that high leveraged firms are more likely to manage earnings not to violate the debt covenant. I include ISSUE_LAG following the argument of Ashbaugh et al(2003) that firms with internal or external financing are involved in more aggressive earning managements than those without financing activities. Following the choi et al (2010), I include the CFO to control the firm performance on discretionary accrual because dependent variable used in this regression is performance adjusted (Kothari et al. 2005). I also include ADJ_TACC_LAG ,which is lagged total variable, to control for variations of reversal effect derived from accruals over time (Choi et al, 2010). Finally, I include industry and year dummies.

5-4. Model for the Association between Abnormal Audit Fees and Audit Quality by introducing IFRS effect in Korean audit service market.

To examine the effect of IFRS adoption on association between abnormal audit fee and discretionary accrual, I include IFRS dummy variable in main regression model.

$$lDAl = \beta_0 + \beta_1 ABAFEE + \beta_2 IFRS + \beta_3 (IFRS*ABAFEE) + \beta_4 ABAFEE + \beta_5 LNTA$$
$$+ \beta_6 BIG + \beta_7 CHGSALE + \beta_8 LOSS + \beta_9 LEV + \beta_{10} ISSUE + \beta_{11} FIRST$$
$$+ \beta_{12} CFO + \beta_{13} ADJ\_TACC\_LAG + industry\ dummies + error\ term \quad (4)$$

partition the sample before and after IFRS adoption and examine the abnormal audit fee-quality relation respectively in each sample to analyze the sensitivity of the IFRS effect based on following regression model.

$$lDAl = \beta_0 + \beta_1 ABAFEE + \beta_2 LNTA + \beta_3 BIG + \beta_4 CHSALE + \beta_5 LOSS + \beta_6 LEV + \beta_7 ISSUE\_P + \beta_8 FIRST + \beta_9 CFO + \beta_{10} ADJ\_TACC\_LAG + industry\ and\ year\ dummies + error\ term \quad (5)$$

VI .Results

I first estimate Equation (3) Using the full sample of 10,856 firm-years. Table (4) shows the regression result using lDAl as dependent variable. As shown in table (4), the coefficient for ABAFEE(t-statistics : 1.66) is positive and significant. Thus it rejects hypothesis 1, meaning that absolute magnitude of discretionary accrual increases as abnormal audit fee increases. Furthermore, I examine interplay of IFRS effect with abnormal audit fee and audit quality relation, the test results also show the positive and significant relationship, which reject hypothesis 2. As shown in the table 5, when Equation (4) is estimated after including IFRS dummy variable, the results show that the coefficient of interaction term, IFRS*ABAFEE (t-statistics : 3.56), which captures the incremental joint effects of abnormally paid audit fees and IFRS adoption, is positively and significantly associated with unsigned magnitude of discretionary accrual at less than the 5 percent level. In addition, the coefficient of IFRS dummy variable (t-statistics : -11.5) is significance at less than 1 percent level in negative direction, meaning IFRS

contributes to the decrease of absolute magnitude of discretionary accruals. The result is consistent with prior literatures (Barth et al 2008; Kuk Hyun Choi and Yeo Jin Choi. 2012). When I split total observations into those with before-IFRS and post-IFRS, the results become more obvious. As shown in the table (5), the coefficient of ABAFEE (t-statistics: 0.58), which is regressed only on before-IFRS firm-year sample, appears no statistical significance. In contrast to this results, the positive and significant coefficient of ABAFEE(t-statistics:3.79), which is regressed only on post-IFRS firm-year sample, indicates that abnormal audit fee paid to auditors increases the absolute magnitude of discretionary accrual by 0.009, which is comparable to the sum of the coefficient(-0.003) and IFRS*ABAFEE(0.0013), 0.01 in regression results from total sample firm-year.

Taken as a whole, these results suggest that association between abnormal audit fees and audit quality differs systematically between before-IFRS period and post-IFRS period. In short, before IFRS adoption, there exists no significant association between abnormal audit fee and audit quality measured by absolute magnitude of discretionary accruals but after IFRS adoption, the relationship between abnormal audit fees and unsigned magnitude of discretionary accruals become significantly positive. In a regression with total sample firm-year, the results show the positive and significant association between the two, which suggests the effect of before-IFRS period dominates that of before-IFRS throughout the whole sample firm year.

[Insert Table 4]

[Insert Table 5]

VII. Further Analyses

I try to perform several analyses to examine the validity of my findings.

First, I test the regressions from table (4) and (5) using different type of absolute value of discretionary accrual following the model of Ball and Shivakumar (2006). The results derived from equation (3) are shown in table 6 of which alternative measure is qualitatively comparable to those of table 4 and test results from equation (4) are presented in table 7 with alternative lDAl, and it also shows qualitatively similar to those reported in table 5.

Second, I also construct a reduced sample of 8,451 firm-year data that adheres to the data requirements to include additional control variable, STD_CFO and STD_REV. According to Hribar and Nichols, STD_CFO and STD_REV need to be controlled for potential biases in case of using absolute value of discretionary accruals as dependent variable (Choi et al,2010). Even after controlling two variables, the results are maintained as shown in table (8) and (9).

Third, I additionally test the asymmetric association between abnormal audit fees and audit quality whether the empirical results from Korean setting are comparable to those from international evidence (Choi et al 2010). I examined the asymmetric association between abnormal audit fees and audit quality in total sample firm-year and furthermore I test the IFRS effect on this relationship. As shown in table (10), the results in total sample firm-year are consistent with those of Choi et al(2010). Firms with positive abnormal audit fees are more likely to have significant and positive association with absolute magnitude of discretionary accruals while firms with negative abnormal audit fees have no association with unsigned magnitude of discretionary accruals. When I introduce IFRS dummy variable in the regression model, interaction term ABAFEE*IFRS is

asymmetrically associated with absolute magnitude of discretionary accrual conditioned upon the sign of abnormal audit fees as shown in table (11). The overall test results are comparable to those of Choi et al (2010).

[Insert Table 6]

[Insert Table 7]

[Insert Table 8]

[Insert Table 9]

[Insert Table 10]

[Insert Table 11]

VIII. Summary and Conclusion

In this paper, I reexamine the association between abnormal audit fees and audit quality in Korean audit service market and test which story, either economic bonding or audit effort, supports this relationship. Test results show the no significant association between abnormal audit fee and audit quality in the pre-IFRS period. However this relationship becomes positive in the post-IFRS period. These results can be incurred by two different reasons. First, IFRS may give some firms with bad intention opportunities to manipulate earnings by using broader choices of discretionary accrual in collusive relationship with auditors, which

supports the economic bonding story. Second, the firms with high level of unsigned discretionary accruals are regarded with high audit risk, thus auditors extend the scope of audit to mitigate audit risk.

My study is based on most up-to-date sample data, from 2008 to 2013, which reflects how the dynamics between abnormal audit fee and audit quality is changing currently. And As far as I know, it is first to examine the interplay of IFRS adoption with the association between abnormal audit fee and quality. The findings of this paper may provide useful insight to information users so some extent about how audit firms and clients respond to IFRS adoption based on their incentives and how these influence the audit quality.

There are some limitations of this paper. First, I cannot find whether abnormally high audit fee paid to auditors enable firms to use more discretion by using wider choices of the absolute magnitude of discretionary accrual or the use of high level of unsigned magnitude of discretionary accruals motivates auditors to extend the scope of audit, thus increase audit fee abnormally. Second, it relies on the assumption that all the published data is reliable but when I check the validity of sample data, there are some discrepancy or missing data of audit fee and hour. Thus I hand collected the data from the Data Analysis, Retrieval and Transfer System (DART), still there exists some missing and invalid information. This may biases against finding a statistically significant result. Third, there may be some omitted variables in audit fee estimation model and main regression model. Fourth, the proxy for audit quality in this paper, absolute magnitude of discretionary accrual, needs to be extended to more diverse and sophisticated measure to strengthen the research results. Therefore the reader should concern about the above mentioned to interpret the research results.

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(Table 1) Sample Selection Procedure

	Number of Obs. Dropped	*Remaining Obs.*
(1) Number of firm-year observations (fiscal year 2006-2013)		*17,017*
(2) Drop observations that do not have valid audit fee,audit hour data	*3,247*	*13,770*
(3) Drop observations for which control variables cannot be caculated	*720*	*13,050*
(4) Drop observations before 2006	*2,194*	*10,856*

(Table 2) Descriptive Statistic

Variable	*Mean*	*Median*	*Std. Dev*	*1%*	*99%*
IDAI	*0.080*	*0.050*	*0.118*	*0.001*	*0.505*
ABAFEE	*0.002*	*-0.017*	*0.433*	*-0.985*	*1.104*
LNTA	*25.715*	*25.409*	*1.443*	*23.000*	*30.000*
BTM	*1.223*	*1.016*	*0.956*	*0.105*	*4.455*
BIG	*0.563*	*1.000*	*0.496*	*0.000*	*1.000*
CHGSALE	*0.163*	*0.054*	*3.710*	*-0.795*	*1.858*
EMPLOY	*19.798*	*14.629*	*20.904*	*3.162*	*110.653*
EXPORT	*0.262*	*0.107*	*0.308*	*0.000*	*0.991*
FOR	*0.064*	*0.011*	*0.113*	*0.000*	*0.542*
GRW_LAG	*0.053*	*0.056*	*0.785*	*-0.842*	*0.974*
INVREV_LAG	*0.271*	*0.258*	*0.158*	*0.000*	*0.680*
LEV_LAG	*0.410*	*0.410*	*0.199*	*0.042*	*0.883*
LIQ_LAG	*2.548*	*1.569*	*2.960*	*0.240*	*19.350*
LOSS	*0.251*	*0.000*	*0.434*	*0.000*	*1.000*
LOSS_LAG	*0.230*	*0.000*	*0.421*	*0.000*	*1.000*
LFEE	*11.128*	*11.002*	*0.696*	*9.903*	*13.430*
LEV	*0.411*	*0.408*	*0.207*	*0.039*	*0.899*
ONER	*0.405*	*0.400*	*0.168*	*0.046*	*0.799*
OPIN_LAG	*0.011*	*0.000*	*0.104*	*0.000*	*1.000*
ISSUE	*0.325*	*0.000*	*0.468*	*0.000*	*1.000*
IFRS	*0.420*	*0.000*	*0.494*	*0.000*	*1.000*
FIRST	*0.175*	*0.000*	*0.380*	*0.000*	*1.000*
CFO	*4.849*	*4.704*	*13.315*	*-28.875*	*38.869*
ROA_LAG	*0.016*	*0.037*	*0.177*	*-0.569*	*0.255*
ADJ_TACC_LAG	*-0.029*	*-0.019*	*0.191*	*-0.516*	*0.342*

(Table 3) Pearson Correlations among Regression Variables

Pearson Correlations among Regression Variables

	IDAI	ABAFEE	LNTA	BIG	CHG SALE	LOSS	LEV	ISSUE	FIRST	CFO
ABAFEE	-0.0281									
	(0.0034)									
LNTA	-0.1785	0.31028								
	(<.0001)	(<.0001)								
BIG	-0.0764	0.02042	0.37132							
	(<.0001)	(0.0334)	(<.0001)							
CHGSALE	0.10374	-0.0453	0.01033	-0.0053						
	(<.0001)	(<.0001)	(0.2819)	(0.5846)						
LOSS	0.2156	0.02438	-0.16	-0.1009	-0.1995					
	(<.0001)	(0.0111)	(<.0001)	(<.0001)	(<.0001)					
LEV	0.15182	0.03372	0.22175	0.01382	0.08499	0.25005				
	(<.0001)	(0.0004)	(<.0001)	(0.1498)	(<.0001)	(<.0001)				
ISSUE	0.08757	0.00456	0.02625	-0.0158	0.07984	0.07281	0.18002			
	(<.0001)	(0.6344)	(0.0062)	(0.0990)	(<.0001)	(<.0001)	(<.0001)			
FIRST	0.05308	0.00035	-0.0517	-0.0593	0.0289	0.01899	0.00587	0.02764		
	(<.0001)	(0.9710)	(<.0001)	(<.0001)	(0.0026)	(0.0478)	(0.5410)	(0.0040)		
CFO	-0.19	-0.0155	0.09085	0.09818	0.09678	-0.3037	-0.1729	-0.0582	-0.0287	
	(<.0001)	(0.1061)	(<.0001)	(<.0001)	(<.0001)	(<.0001)	(<.0001)	(<.0001)	(0.0028)	
ADJ_TACC	-0.2336	-0.0143	0.09844	0.04467	0.07194	-0.3284	-0.1342	-0.0347	0.00159	-0.1909
	(<.0001)	(0.1376)	(<.0001)	(<.0001)	(<.0001)	(<.0001)	(<.0001)	(0.0003)	(0.8683)	(<.0001)

(Table 4) Empirical Results on the Association between Discretionary Accruals and Abnormal Audit Fees in Korea audit service market

Dep. Var =	IDAI (discretionary accruals)		
	Coeff.	Pr > |t|	t Value
Intercept	0.2569	<.0001	7.88
ABAFEE	0.0032	0.0963	1.66
LNTA	-0.0091	<.0001	-13.34
BIG	0.0004	0.8297	0.22
BTM	-0.0163	<.0001	-17.76
CHGSALE	0.0229	<.0001	10.76
LOSS	0.0272	<.0001	13.71
LEV	0.0411	<.0001	9.57
ISSUE	0.0065	<.0001	3.91
FIRST	0.0017	0.4146	0.82
CFO	-0.0008	<.0001	-13.03
ADJ_TACC_LAG	-0.0237	<.0001	-5.62
Year effects		Included	
Industry effects		Included	
Adj. Rsq.		0.1686	
Obs.		10,856	

(Table 5) Empirical Results on the Association between Discretionary Accruals and Abnormal Audit Fees by introducing IFRS effect in Korea audit service market

Dep. Var =	IDAI								
	Total Sample			Before IFRS Adoption			After IFRS Adoption		
	Coeff.		t-stat	Coeff.		t-stat	Coeff.		t-stat
Intercept	0.272	<.0001	8.34	0.279	<.0001	6.14	0.236	<.0001	5.27
ABAFEE	-0.003	0.2786	-1.08	-0.002	0.5621	-0.58	0.009	0.0002	3.79
IFRS	-0.018	<.0001	-11.5						
IFRS*ABAFEE	0.013	0.0004	3.56						
LNTA	-0.009	<.0001	-13.4	-0.009	<.0001	-9.74	-0.008	<.0001	-9.33
BIG	0.001	0.7161	0.36	-0.001	0.7666	-0.3	0.001	0.5895	0.54
BTM	-0.014	<.0001	-15.5	-0.017	<.0001	-12.39	-0.016	<.0001	-13.23
CHGSALE	0.025	<.0001	11.91	0.029	<.0001	10.27	0.009	0.008	2.65
LOSS	0.029	<.0001	14.59	0.034	<.0001	11.76	0.019	<.0001	6.99
LEV	0.043	<.0001	9.91	0.033	<.0001	5.45	0.055	<.0001	9.57
ISSUE	0.007	<.0001	3.95	0.009	0.0001	3.88	0.002	0.4334	0.78
FIRST	0.006	0.0023	3.05	-0.001	0.8049	-0.25	0.006	0.0291	2.18
CFO	-0.001	<.0001	-12.9	-0.001	<.0001	-11.24	-0.001	<.0001	-5.01
ADJ_TACC_LAG	-0.022	<.0001	-5.16	-0.024	<.0001	-4.76	-0.006	0.5066	-0.66
Year effects	Not Included			Included			Included		
Industry effects	Included			Included			Included		
Adj. Rsq.	0.1607			0.1697			0.1429		
Obs.	10,856			6,293			4,563		

(Table 6) Empirical Results on the Association between Discretionary Accruals and Abnormal Audit Fees in Korea audit service market (Ball and Shivakumar 2006)

Dep. Var =	IDAI (discretionary accruals)		
	Coeff.	Pr > |t|	t Value
Intercept	0.27336	<.0001	7.09
ABAFEE	0.00680	0.0026	3.01
LNTA	-0.00940	<.0001	-11.7
BIG	0.00020	0.9203	0.1
BTM	-0.02069	<.0001	-19.06
CHGSALE	0.01627	<.0001	6.47
LOSS	0.04770	<.0001	20.35
LEV	0.01598	0.0017	3.14
ISSUE	0.00482	0.0138	2.46
FIRST	0.00108	0.6587	0.44
CFO	-0.00058	<.0001	-7.98
ADJ_TACC_LAG	-0.01378	0.0057	-2.77
Year effects		Included	
Industry effects		Included	
Adj. Rsq.		0.1507	
Obs.		10,856	

(Table 7) Empirical Results on the Association between Discretionary Accruals and Abnormal Audit Fees by introducing IFRS effect in Korea audit service market.(Ball and Shivakumar 2006)

Dep. Var =	IDAI								
	Total Sample			Before IFRS			After IFRS		
	Coeff.		t-stat	Coeff.		t-stat	Coeff.		t-stat
Intercept	0.284	<.0001	7.35	0.316	<.000	5.62	0.226	<.000	4.85
ABAFEE	0.000	0.8699	0.16	0.003	0.46	0.73	0.012	<.000	5.01
IFRS	-0.019	<.0001	-10						
IFRS*ABAFEE	0.013	0.0015	3.18						
LNTA	-0.009	<.0001	-12	-0.011	<.000	-9	-0.008	<.000	-7.98
BIG	0.001	0.7736	0.29	-0.004	0.19	-1.3	0.005	0.04	2.05
BTM	-0.018	<.0001	-17	-0.023	<.000	-14	-0.018	<.000	-14.7
CHGSALE	0.019	<.0001	7.81	0.025	<.000	7.18	-0.005	0.14	-1.46
LOSS	0.050	<.0001	21.4	0.059	<.000	16.8	0.032	<.000	11.71
LEV	0.018	0.0005	3.46	0.014	0.07	1.84	0.023	0	3.84
ISSUE	0.005	0.0125	2.5	0.007	0.01	2.5	0.001	0.77	0.29
FIRST	0.007	0.0066	2.72	0.001	0.78	0.28	0.002	0.44	0.77
CFO	-0.001	<.0001	-7.9	-0.001	<.000	-7.4	-5.930	0.6	-0.52
ADJ_TACC_LAG	-0.011	0.0218	-2.3	-0.008	0.22	-1.2	-0.019	0.05	-1.95
Year effects		Not Included			Included			Included	
Industry effects		Included			Included			Included	
Adj. Rsq.	0.1409			0.1608			0.1304		
Obs.	10,856			6,293			4,563		

(Table 8) Empirical Results on the Association between Discretionary Accruals and Abnormal Audit Fees in Korea audit service market (After controlling for STD_CFO and STD_REV variables)

Dep. Var =	IDAI (discretionary accruals)		
	Coeff.	Pr > |t|	t Value
Intercept	0.277	<.0001	5.78
ABAFEE	0.006	0.0209	2.31
LNTA	-0.011	<.0001	-10.77
BIG	0.000	0.9956	-0.01
BTM	-0.017	<.0001	-14.4
CHGSALE	0.003	<.0001	13.11
LOSS	0.023	<.0001	8.38
LEV	0.076	<.0001	12.56
ISSUE	0.003	0.2298	1.2
FIRST	-0.001	0.8518	-0.19
CFO	-69.702	<.0001	-9.61
ADJ_TACC_LAG	-0.029	<.0001	-3.91
STD_CFO	0.001	0.4129	0.82
STD_REV	0.010	<.0001	3.93
Year effects		Included	
Industry effects		Included	
Adj. Rsq.		0.1561	
Obs.		8,451	

(Table 9) Empirical Results on the Association between Discretionary Accruals and Abnormal Audit Fees by introducing IFRS effect in Korea audit service market. (After controlling for STD_CFO and STD_REV variables)

Dep. Var =	IDAI								
	Total Sample			Before IFRS Adoption			After IFRS Adoption		
	Coeff.		t-stat	Coeff.		t-stat	Coeff.		t-stat
Intercept	0.301	<.0001	6.27	0.310	0.0001	3.82	0.234	<.0001	4.42
ABAFEE	-0.001	0.7235	-0.35	0.002	0.7001	0.39	0.011	0.0001	3.82
IFRS	-0.024	<.0001	-10.8						
IFRS*ABAFE	0.013	0.0115	2.53						
LNTA	-0.011	<.0001	-10.9	-0.012	<.0001	-6.77	-0.009	<.0001	-8.37
BIG	0.001	0.7699	0.29	-0.002	0.6436	-0.46	0.003	0.3015	1.03
BTM	-0.014	<.0001	-12.3	-0.018	<.0001	-9.03	-0.015	<.0001	-11.5
CHGSALE	0.004	<.0001	13.47	0.003	<.0001	10.93	0.004	0.1073	1.61
LOSS	0.025	<.0001	8.91	0.030	<.0001	6.28	0.018	<.0001	5.88
LEV	0.079	<.0001	12.96	0.078	<.0001	7.52	0.075	<.0001	11.2
ISSUE	0.003	0.1649	1.39	0.005	0.2758	1.09	-0.001	0.7649	-0.3
FIRST	0.006	0.0266	2.22	-0.005	0.2942	-1.05	0.006	0.0982	1.65
CFO	-0.001	<.0001	-9.7	-0.001	<.0001	-7.75	0.000	0.0002	-3.67
ADJ_TACC_	-0.025	0.0008	-3.37	-0.033	0.0021	-3.08	-0.010	0.3097	-1.02
STD_CFO	0.001	0.3962	0.85	0.122	<.0001	8.49	0.000	0.7744	0.29
STD_REV	0.010	<.0001	4.03	-0.005	0.264	-1.12	0.011	0.0003	3.66
Year effects	Not Included			Included			Included		
Industry effects	Included			Included			Included		
Adj. Rsq.	0.1453			0.1746			0.1306		
Obs.	8,451			3,935			4,516		

(Table 10) Empirical Results on the asymmetric relation between Discretionary Accruals and Abnormal Audit Fees in Korea audit service market

Dep. Var =	*IDAI*					
	Positive abnormal audit fee			*Negative abnormal audit fee*		
	Coeff.		*t-stat*	*Coeff.*		*t-stat*
Intercept	*0.3204*	*<.0001*	*6.25*	*0.1911*	*<.0001*	*4.42*
ABAFEE	*0.0085*	*0.06*	*1.88*	*-0.0035*	*0.342*	*-0.95*
LNTA	*-0.0123*	*<.0001*	*-12.22*	*-0.0062*	*<.0001*	*-6.19*
BIG	*0.0022*	*0.3915*	*0.86*	*-0.0002*	*0.9281*	*-0.09*
BTM	*-0.0167*	*<.0001*	*-13.14*	*-0.0160*	*<.0001*	*-11.97*
CHGSALE	*0.0143*	*<.0001*	*4.56*	*0.0300*	*<.0001*	*10.41*
LOSS	*0.0331*	*<.0001*	*11.69*	*0.0207*	*<.0001*	*7.42*
LEV	*0.0546*	*<.0001*	*8.85*	*0.0308*	*<.0001*	*5.1*
ISSUE	*0.0071*	*0.0029*	*2.98*	*0.0060*	*0.0089*	*2.62*
FIRST	*0.0004*	*0.8923*	*0.14*	*0.0022*	*0.4333*	*0.78*
CFO	*-0.0005*	*<.0001*	*-4.98*	*-0.0010*	*<.0001*	*-12.7*
*ADJ_TACC_*	*-0.0170*	*0.009*	*-2.61*	*-0.0287*	*<.0001*	*-5.18*
Year effects		*Not Included*			*Included*	
Industry effects		*Included*			*Included*	
Adj. Rsq.		*0.1762*			*0.177*	
Obs.		*5,211*			*5,645*	

(Table 11) Empirical Results on the asymmetric relation between Discretionary Accruals and Abnormal Audit Fees by introducing IFRS effect in Korea audit service market

Dep. Var =	*IDAI*					
	Positive abnormal audit fee			*Negative abnormal audit fee*		
	Coeff.		*t-stat*	*Coeff.*		*t-stat*
Intercept	*0.3320*	*<.0001*	*6.47*	*0.2188*	*<.0001*	*5.06*
ABAFEE	*0.0015*	*0.7973*	*0.26*	*-0.0098*	*0.082*	*-1.74*
IFRS	*-0.0193*	*<.0001*	*-5.7*	*-0.0181*	*<.0001*	*-5.72*
*IFRS*ABAFE*	*0.0153*	*0.0388*	*2.07*	*0.0111*	*0.1389*	*1.48*
LNTA	*-0.0122*	*<.0001*	*-12.1*	*-0.0067*	*<.0001*	*-6.63*
BIG	*0.0024*	*0.3528*	*0.93*	*0.0001*	*0.9683*	*0.04*
BTM	*-0.0145*	*<.0001*	*-11.84*	*-0.0128*	*<.0001*	*-9.94*
CHGSALE	*0.0170*	*<.0001*	*5.46*	*0.0320*	*<.0001*	*11.23*
LOSS	*0.0345*	*<.0001*	*12.21*	*0.0230*	*<.0001*	*8.25*
LEV	*0.0557*	*<.0001*	*9.01*	*0.0334*	*<.0001*	*5.5*
ISSUE	*0.0072*	*0.0027*	*3*	*0.0062*	*0.0071*	*2.69*
FIRST	*0.0045*	*0.1228*	*1.54*	*0.0074*	*0.008*	*2.65*
CFO	*-0.0005*	*<.0001*	*-4.88*	*-0.0010*	*<.0001*	*-12.6*
*ADJ_TACC_*	*-0.0148*	*0.0226*	*-2.28*	*-0.0271*	*<.0001*	*-4.86*
Year effects		*Not Included*			*Included*	
Industry effects		*Included*			*Included*	
Adj. Rsq.		*0.1762*			*0.177*	
Obs.		*5,211*			*5,645*	

Description of Variables

LNTA	=	*The natural log of total assets*
BTM	=	*Book-to market ratio*
CHGSALE	=	*Sales change from the prior year divided by the prior year's beginning total assets*
EMPLOY	=	*Square root of number of employees*
EXPORT	=	*The proportion of export sales to total sales*
FOR	=	*Percentile rank of foreign ownership*
GRW_LAG	=	*Growth in sales in year t-1*
INVERC_LAG	=	*Percentile rank of the inventory and account receivable (inventory + account receivable)/ total asset in year t-1*
LEV	=	*Long-term and short-term bond and debt deflated by asset*
ONER	=	*Percentile rank of the ownership by largest shareholder and related parties*
OPIN_LAG	=	*1 if financial statement for the firm-year in the firm-year is Restated, and 0 otherwise in year t-1*
ISSUE	=	*1 if the number of shares outstanding or public bond issuance increased by at least 10 percent, and 0 otherwise;*
IFRS	=	*1 if the firm is audited by a big 4 audit firm, and 0 otherwise.*
CFO	=	*Cash flow from operation divided by lagged total assets.*
ROA_LAG	=	*Net income deflated by total assets in year t-1*
ADJ_TACC	=	*Total accruals adjusted by total asset in year t-1*
DA	=	*Discretionary accruals*
/DA/	=	*The absolute magnitude of discretionary accruals*
ABAFEE	=	*Abnormal audit fee*
BIG	=	*1 if the firm is audited by a big 4 audit firm, and 0 otherwise*
LIQ_LAG	=	*Current assets divided by current liabilities in year t-1*
LOSS	=	*1 if the firm is reporting a loss, and 0 otherwise*
LOSS_LAG	=	*1 if the firm is reporting a loss, and 0 otherwise in year t-1*
LFEE	=	*Long-term and short-term bond and debt deflated by asset*
FIRST	=	*1 if a company is audited for the first time and 0 otherwise;*
STD_CFO	=	*standard deviations of operating cash flow (deflated by lagged total assets) for the years $t-5$ to t*
STD_REV	=	*standard deviations of cash-based revenues by lagged total assets_ for the years $t-5$ to t.*

국문초록

본 논문은 국제회계기준 도입이 비정상 감사보수와 감사품질의 관계에 어떠한 영향을 미쳤는지를 실증분석을 통해 살펴보고자 한다. 먼저 2008년부터 2013년까지 수집된 데이타를 바탕으로 국제회계기준 도입 이전의 비정상 감사보수와 재량적 발생액으로 측정된 감사품질의 관계를 분석해본 결과, 유의적인 상관관계가 없는 것으로 나타났다. 반면 국제회계기준 도입 이후에는 비정상 감사보수와 감사품질 간에 유의적인 양의 상관관계가 관찰되었다. 이 실증분석 결과는 두 가지 가능성을 시사하는데, 한 가지는 국제회계기준 도입 이후, 감사인이 감사대상인 고객 회사에게 회계처리의 재량권을 허용해준 대가로 비정상적인 감사수수료를 받을 가능성이고 다른 한 가지는 국제회계기준 도입 이후, 기업들이 재량적 발생액을 이용해 손익을 조작할 가능성이 있다는 것이다. 감사인들은 이에 대비하여 감사범위 확장하여 감사위험을 줄이고자 할 유인이 있으며 비정상감사보수는 이에 따른 감사보수 상승분을 반영한 결과일 가능성이다. 본 논문은 어떤 인과관계에 의해 비정상 감사보수와 재량적 발생액 간에 양의 상관관계가 성립되었는지에 대해 제시해주고 있지는 않으나, 국제회계기준 도입이 비정상 감사보수와 재량적 발생액 관계에 유의미한 영향을 미쳤다는 것을 증명했다는 것과 향후 본 논문주제에 대한 추가연구 가능성을 열었다는 점에서 그 의의를 찾을 수 있다.

주 요 어 : 국제회계기준, 재량적 발생액, 비정상 감사보수, 감사품질

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